

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SER:IDD:IND:TL-N-4280-99

RTJordan

date: JUL 20 1999

to: Chief, Examination Division, Delaware-Maryland District
Case Manager Ken Hewett and Revenue Agent Joyce Leso

from: RONALD T. JORDAN
Special Litigation Attorney

subject: [REDACTED]
Computation of Deficiency Interest

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

This memorandum is in response to your request for assistance in determining the dates from which interest should be assessed on income tax deficiencies.

ISSUE

Under the circumstances noted below, when should interest begin accruing on deficiencies in income taxes for the fiscal years ending March 31, [REDACTED] and [REDACTED]?

11057

CONCLUSION

Interest on the deficiencies in income taxes from the fiscal years ending March 31, [REDACTED] and [REDACTED] should begin accruing on the respective dates of June 15, [REDACTED] and June 15, [REDACTED].

FACTS

On the original income tax returns of [REDACTED] [REDACTED] ([REDACTED]) filed for fiscal years ended March 31, [REDACTED] and March 31, [REDACTED], [REDACTED] reported overpayments of \$ [REDACTED] and \$ [REDACTED]. For both years, [REDACTED] elected to carry forward the overpayments to be applied to estimated tax payments in the subsequent year.

For fiscal year ending March 31, [REDACTED], [REDACTED] fully paid its four estimated tax installments without applying any of the overpayment from the [REDACTED] fiscal year. As stated above, the tax return for fiscal year ending March 31, [REDACTED] reported an overpayment of \$ [REDACTED]. Thus, at the end of the [REDACTED] fiscal year the entire overpayment from the [REDACTED] fiscal year plus excess payments made during the [REDACTED] fiscal year were available to be refunded to the taxpayer or carried forward to future years. [REDACTED] elected to carry forward the overpayment.

For fiscal year ending March 31, [REDACTED], [REDACTED] fully paid its first two estimated tax installments without applying any of the overpayment from the [REDACTED] fiscal year. The third installment utilized \$ [REDACTED] of the \$ [REDACTED] carryforward from [REDACTED]. The fourth installment utilized an additional \$ [REDACTED] of the \$ [REDACTED] carryforward from [REDACTED]. Thus, at the end of the fiscal year ending March 31, [REDACTED], a balance of \$ [REDACTED] of the \$ [REDACTED] amount carried forward from [REDACTED] remained unutilized.

Years later, the income tax returns of [REDACTED] for fiscal years ending March 31, [REDACTED] and [REDACTED] were examined. Deficiencies in income taxes were agreed to by the taxpayer in the amount of \$ [REDACTED] for fiscal year ending March 31, [REDACTED] and \$ [REDACTED] for fiscal year ending March 31, [REDACTED]. The question at issue in this memorandum is when should interest begin accruing on these deficiencies?

DISCUSSION

Under the authority of Rev. Rul. 84-58, 1984-1 C.B. 254, it has been the practice of the IRS to automatically apply overpayments of tax to the first installment of estimated tax due

for the next year. This was so even if the taxpayer remitted other funds sufficient to pay the installment.

However, the recent case of May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), has forced the IRS to reconsider and change this rule. In that case the court held that so long as an overpayment was not specifically applied by a taxpayer to an installment of estimated tax and other funds were provided by the taxpayer to fully pay the installment, the overpayment would not be treated as applied to the installment for interest computation purposes. Thus, the court concluded that, if all four installments of estimated tax were paid with funds other than the overpayment from the previous year, interest on a subsequently prior year deficiency in tax would not begin running before the date of filing of the subsequent year's return. The IRS has acquiesced in that decision. AOD CC-1997-008.

Having said the above, when should interest on [REDACTED]'s [REDACTED] and [REDACTED] deficiencies begin running? Some commentators have suggested that if there is an overpayment equal to or greater than the deficiency in tax in the year to which the overpayment for the deficiency year is applied, interest should not begin running until that overpayment is applied to future year's tax liabilities. See also, Sequa Corporation v. United States, 97-1 USTC ¶ 50,317 (S.D.N.Y. 1996). However, this is not the case. Under Treas. Reg. § 301.6402-3(b)(5), overpayments that are applied to estimated tax payments for the subsequent year can only be applied to the immediate following year. Thus, any overpayment arising in the subsequent year that would arguably include funds overpaid in the previous year is treated as a payment for the subsequent year. This position is the position that has been adopted by the Office of Chief Counsel.

Applying the above principles, interest on the deficiency for the period ending March 31, [REDACTED], should begin accruing on June 15, [REDACTED], the due date of the taxpayer's March 31, [REDACTED] return. This is so because all estimated tax installments for the [REDACTED] year were paid by [REDACTED] with funds other than the overpayment from [REDACTED]. Moreover, since an overpayment cannot be treated as applied to any year other than the next immediate year, [REDACTED] is the date on which the [REDACTED] overpayment is deemed to have been utilized.

The above analysis is equally applicable to the income tax deficiency for the period ending [REDACTED]. Although a total of \$[REDACTED] of the \$[REDACTED] overpayment from [REDACTED] was applied to the third and fourth installments in [REDACTED], a balance of \$[REDACTED] of the [REDACTED] overpayment remained at year end. Since the \$[REDACTED] remaining at year end exceeds the \$[REDACTED]

deficiency in tax interest the deficiency should not begin to run until June 15, [REDACTED], the due date of the [REDACTED] return.

If you wish to discuss the above or have any other questions, please contact me at 317-226-6610. For your information, I am forwarding this memorandum to the Office of Chief Counsel, Field Service, under the Significant Advice Review program. The Field Service Division should contact me within ten working days to express concurrence or disagreement with the conclusions stated herein. I will advise you after I have been contacted by that office.

(Signed) RONALD T. JORDAN
RONALD T. JORDAN
Special Litigation Attorney

CC: Ross Springer, District Counsel
CC: Roy Allison, Assistant Regional Counsel (TL)
CC: Office of Assistant Chief Counsel, Field Service